

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer

Natwar M. Gandhi
Chief Financial Officer



MEMORANDUM

TO: The Honorable Linda W. Cropp
Chairman, Council of the District of Columbia

FROM: Natwar M. Gandhi
Chief Financial Officer

DATE: June 27, 2001

SUBJECT: Fiscal Impact Statement: "Water and Sewer Authority Public
Utility Designation Act of 2001"

REFERENCE: Bill Number 14-4

Conclusion

The basic structure of the District of Columbia Water and Sewer Authority (WASA) as a public utility is not addressed in the proposed legislation. As a consequence, it is not possible to estimate the fiscal impact of this bill. It may be substantial.

If the structural change of WASA and the potential redistribution of government-owned assets are not considered, it is possible to estimate some of the fiscal impacts on the District's budget and financial plan. The amount of O-type revenue the District receives in FY 2002 from WASA will increase by approximately \$1.4 million, the amount it will cost the Public Services Commission and the Office of the People's Counsel to conduct the activities in the proposed legislation. The District government's increased water costs will be exactly offset by WASA's payment-in-lieu-of-taxes (PILOT) to the District government.

Background

The proposed legislation amends D.C. Code, Section 43-203 to establish WASA as a public utility. The proposed legislation also amends D.C. Code, Section 43-1686 to give the District of Columbia Public Service Commission (PSC) the authority to regulate the activities of WASA, particularly those concerning the establishment and adjustment of retail rates.

The PSC and the Office of the People's Counsel (OPC) were chartered as independent agencies of the District Government. The purpose of the PSC is to regulate the local gas, electric, and telephone industries, and should the proposed legislation pass, the water and wastewater industry also. OPC's role is to advocate for District public utility consumers.

Under existing law, the PSC and the OPC are funded through O-type revenue from all regulated utilities. Each utility contributes a percentage of its revenue to both the PSC and OPC for general operating expenses. Public utilities also reimburse the PSC for formal proceedings expenses; the funds collected for proceedings are set up in liability accounts for each utility. Any unused funds received by PSC from a public utility for its regulatory activities are returned to the public utility.

In accordance with a Memorandum of Understanding (MOU) between WASA and the District's Chief Financial Officer (CFO), WASA contributes an annual payment-in-lieu-of-taxes (PILOT) for services it receives from the District, instead of paying property or franchise taxes. The PILOT is equal to the lesser of 1) FY 1999 water and sewer charges inflated annually by the system-wide water rate increase, or 2) a cost certificate certified by the CFO. The cost certificate is an estimate of both the value of District-wide services provided to WASA, such as police and fire protection, and specific services provided by the District, such as financial services. The District-wide services estimate is the calculation of the property tax rate applied to the utility's net depreciated assets. The cost for specific services is estimated as the proportional cost to the specific agency of providing those services to WASA.

Financial Plan Impact

The basic structure of WASA as a public utility is not addressed in the proposed legislation. As a consequence, it is not possible to estimate the fiscal impact of this bill. It may be substantial.

The PSC and the OPC are funded through O-type revenue from all regulated utilities. Thus, should WASA be treated as a public utility, it will be required to contribute to the PSC and OPC, enough to offset any additional operating expenses the two agencies may incur due to their expanded regulatory responsibilities. It is estimated that PSC will incur approximately \$560,000 in additional general operating expenses each year and the OPC will incur approximately \$400,000 in additional annual expenses. Although the anticipated additional expenditures by the PSC and the OPC are unbudgeted in the FY 2002 through FY 2005 budget and financial plan, these expenditures will be paid for by WASA.

WASA will also be billed by the PSC for any expenses incurred for any formal proceedings, the costs of which average approximately \$415,000 per proceeding. For the purposes of this fiscal impact statement, it is assumed that WASA will engage in one

formal proceeding per year. Therefore, as a result of the proposed legislation, WASA will incur approximately \$1.4 million in additional expenses for the support of PSC and OPC general operating expenses and an average of one formal proceeding each year.

In addition to the direct support that WASA will provide PSC and OPC, WASA will incur its own expenses for formal proceedings. WASA estimates it will require significant additional staffing and consulting services in its finance and legal areas, although the specific positions and cost for each cannot be estimated at this time. In total, WASA estimates that a typical rate case or other formal proceeding would cost the entity approximately \$2 million. The costs to WASA and to PSC and OPC for rates cases depends on the complexity of the cases and also the frequency with which WASA petitions to raise its rates.

WASA also anticipates additional costs to change a number of other operational practices in order to comply with regulations set forth by the PSC, including requirements for reporting and accounting.

WASA currently carries high bond ratings (A1/A/A+) on its outstanding bonds. Although the impact is unclear at this time, any changes in its governance structure and rate-setting authority could have an impact on WASA's bond ratings. Any bond rating change may result in an increase in interest rates, and therefore increase WASA's overall debt service costs.

As a result of the increased expenditures anticipated by WASA and given its financial structure, WASA will have to raise its rates in order to generate enough revenue to offset the additional expenses. As a WASA customer, the District government's water usage costs will likely increase. However, according to the MOU between WASA and the CFO, WASA's payment to the District will equal the amount paid the previous year inflated by any system-wide rate increase issued that year by WASA or the cost certificate amount issued by the CFO, whichever is the lesser amount. The amount WASA paid the District in FY 2000 was approximately \$9.2 million, which is equivalent to the FY 1999 PILOT inflated by a 4.8 percent rate increase. Unless the District's water usage increases at a greater rate than the system-wide rate increase, then the District's water and sewer charges and the PILOT will essentially increase at the same rate.